

AREAS OF RECURRING TAXPAYER NONCOMPLIANCE

RETURNS PROCESSING CENTER (RPC)

The primary goal of the Returns Processing Center is to insure that all returns and payments are received, processed and posted in a timely and accurate manner. New technology is constantly being developed to facilitate this process. Although the Department receives a greater number of returns and payments electronically each successive year, it still processes over six million paper returns for 43 different tax and fee types; and, it continues to have problems with the following areas of recurring taxpayer noncompliance. Such problems cause additional work for Department employees, thereby delaying the timely processing of the returns and often causing late fees, penalties and interest.

Math Calculation

Erroneous math calculations are the chief error made on all forms. The error rate is much higher on paper returns of all tax types than on electronically-filed returns. The following is a brief listing of the highest percentage of errors by filing method and tax type.

Individual paper-filed returns: state and county tax math calculations

Estimated Tax: claiming incorrect amounts

Individual electronically-filed returns: Earned Income Credit information missing

Corporate paper-filed returns: math calculation errors

Corporate electronically-filed returns: estimated credit claiming incorrect amounts

Sales Tax paper-filed returns: duplicate filings

Withholding Tax paper-filed returns: duplicate filings

Coupons in General

When printing with the Adobe Acrobat Reader, taxpayers often have their property values set to “shrink to fit page.” When a voucher is printed in this mode, the entire voucher shrinks, and the scan line and amount due print too high on the page to be read.

Use of Non-Department Payment Coupons

Each year the Department provides preprinted coupon vouchers to taxpayers who are registered with the Department and have a previous history of filing coupons. Relevant tax types include: sales tax, withholding tax, estimated tax for both individuals and corporations, and various other taxes and fees. Each month, the Department receives several thousand payments without coupons, others with handwritten information on pieces of paper, coupons from prior filing periods with handwritten changes to fit the time periods for which the taxpayers are trying to file, or payments with no explanation at all. In addition, the Department receives numerous coupons generated by tax preparation software that cannot be processed by its automated equipment. These coupons have to be manually processed, which delays payment postings to taxpayers’ accounts.

Post Filing Coupon (PFC)

Post Filing Coupons are used to pay additional tax on the Indiana Individual Income Tax Return. In order for scanning equipment to properly recognize taxpayers and the amounts of their payments, PFC’s must have the dollar amount and scanline in an “**OCR-A Extended**” font. When this is not the case, erroneous tax notices can be issued by the Department.

The Department has found that the scanlines on coupons from at least three software vendors do not include this required font. Officials from those companies say that tax practitioners are not downloading the font when they download the documents for printing. The Department has suggested that software companies “hard code” the required font into their documents for the scanline and dollar amount.

Failure to Complete All the Required Lines/Information

The Department receives numerous incomplete returns, which greatly delays processing. Department personnel must either complete the returns based on information provided, contact the taxpayers, or mail back the returns

to taxpayers for additional information. All of these options hinder the Department's ability to process returns quickly and efficiently.

Duplicate Returns

Some taxpayers file returns electronically, as well as paper copies of the same returns, thus creating duplicate returns. The second, duplicate returns received by the Department's computer system will "suspend" and then have to be reviewed individually by tax analysts.

Filing the Wrong Return

The Department receives numerous returns each year which are either 1) on the correct forms but for the wrong year, or 2) on the wrong forms but for the correct year. An example would be taxpayers' submitting IT-40EZ forms, even though they do not qualify for that form because of type of income or deductions.

Taxpayers who are residents of reciprocal states often file on Indiana Forms IT-40 and take their home states' deductions, rather than filing the appropriate Indiana Forms IT-40RNR (Reciprocal Nonresident).

Missing W-2 Detail on 2-D Barcoded Returns

In 2004, the Department began requesting the detailed W-2 information on 2-D returns from software vendors in order that our Returns Processing System (RPS) could validate the amounts being claimed as Indiana State and County Withholding on the IT-40. Due to miscommunications on the Department's part, this practice was turned off within the RPS in 2004, but it was resurrected in 2005.

It has been noticed during the 2005 processing season that, even though most 2-D returns did include the detailed W-2 information, we still received over 50,000 2-D returns that did not.

Although this problem is not limited to one particular software vendor, the majority of these 2-D returns with missing W-2 data came from Intuit's Professional users. In most cases, the Employers' Federal I.D. numbers were missing; thus, all W-2 information was dropped. We also experienced similar issues with the software companies of CCH Incorporated, Creative Solutions, Drake Enterprises, H & R Block, TaxWorks, Petz Enterprises, and even our own Internet provider, accessIndiana.

With the number of 2-D returns missing this data growing so quickly and the fact that hard copies of the W-2 forms were attached to the 2-D returns in most cases, we again decided to turn off the review code within the RPS for the remaining portion of 2005. We will discuss this issue again with the software vendors to see what can be done to eliminate this issue for the 2006 processing season.

Failure to Use Barcode Technology

Even when their software is capable of printing barcodes, some taxpayers are not taking advantage of this service.

Failure to Attach W-2 Forms to Returns

The Department receives a vast number of Individual Income Tax returns without W-2 forms to verify the withholding taxes taken as credits on the returns. Failure to submit W-2 forms causes the returns to be rejected and returned to taxpayers with requests for correct documentation.

Failure to Attach W-2 Forms to the WH-3

The WH-3 is a reconciliation of the W-2 forms for employers; both the WH-3 and all W-2 forms must be submitted together annually. The Department often receives WH-3 forms without W-2 forms attached. It also often finds cases of taxpayers changing business names during the year but continuing to file their taxes under their previous Identification Number, and then using the incorrect forms at the end of the year to submit their withholding information for the year. Although the Department provides for the filing of WH-3 and W-2 forms using magnetic media, few taxpayers take advantage of this technology.

Failure to Attach the Necessary Schedules

The Department finds that taxpayers often take deductions or credits on their tax returns, but fail to include

documentation or necessary schedules to substantiate the deductions or credits being taken (e.g., College Credit, Form CC-40).

Failure to Comply with Enterprise Zone Deduction

Taxpayers who live in Enterprise Zones and work for qualified employers in those zones may be qualified to take the Enterprise Zone Deduction. The deduction is one-half of the earned income shown on Form IT-40QEC, or \$7,500, whichever is less. In most cases, the deductions are calculated incorrectly, or the Forms IT-40QEC that should be completed and submitted by the employers are not attached to the taxpayers' Forms IT-40.

IT-9, Extension Payment Voucher

Taxpayers file Form IT-9, even though no tax is due; or, they file the form, showing taxes due, but fail to include a payment.

Penalty for Underpayment of Estimated Tax

Taxpayers who don't have taxes withheld from their income and/or don't pay sufficient estimated taxes throughout the year usually owe penalties for underpayment of estimated taxes. Generally speaking, taxpayers who owe \$400.00 or more in state and county taxes for the year but do not have taxes withheld from paychecks need to make estimated tax payments during the year.

Failure to Calculate County Tax

Often taxpayers fail to compute their county taxes. If taxpayers lived and/or worked in Indiana counties that have county taxes on January 1 of the tax year, they must compute the amount of county tax due at the applicable rate. Failure to calculate county taxes due may delay processing of their returns.

Improper Completion of County Boxes

Some IT-40's are received with "00" inappropriately marked in the county boxes. (An example is "00" entered in the spouse boxes for a single taxpayer.) The Department's computer system recognizes "00" as meaning a non-reciprocal, out-of-state county.

Fuel Tax — Common Reporting Errors

A review of previously-filed monthly special fuel and gasoline tax returns has revealed the following most common reporting errors on Forms FT-1, SF-701, MF-360, SF-900, SF-401, MF-600, SF-801, SF-IVP and FT-501, as well as Schedules 1A, 2A, 3A, 5 through 10, 501A, 501B and 501I:

- Return not signed
- Amount due not included with return
- Payment submitted without return
- Missing schedules
- Incomplete information provided on schedules
- Transactions reported in the wrong month (All special fuel transactions must be reported in the month in which they occur.)
- Same deductions claimed on more than one schedule
- More than one fuel type reported on same schedule
- Export schedules not filed in duplicate, as required
- Dyed fuel transactions reported on schedules designated for clear fuel
- Deliveries of special fuel with an Indiana destination misreported on export schedules
- Truck deliveries misreported on Schedule 6 (detail of disbursements reported on Forms SF-900 and MF-360)
- Computer-generated forms/schedules that do not conform to Department requirements
- Not filing dyed fuel use schedule correctly

Environmental Tax — Common Reporting Errors

A review of previously-filed environmental returns has revealed the following common reporting errors on Forms UST-1, HC-500, HW-020 and SW-100:

- Return not signed
- No Federal I.D. Number/Social Security Number

- Amount due not included with return
- Payment submitted without return
- Payment amount is different than amount due
- Missing schedules
- Duplicate filing

Trust Taxes – Check Stubs

When stubs are attached to checks accompanying trust tax returns, their envelopes can not be processed by the Department's automated mail-opening equipment. These envelopes must go through an assisted mail-opening procedure before the checks can be processed for deposit, which creates additional expense for the Department and delays deposits.

Trust Taxes – Retail Sales and Use Tax and/or Withholding Tax

- Many taxpayers continually fail to use the template provided to them in the payment coupon packet to accurately enter information on the correct lines of their ST-103. This invariably causes their returns to be “suspended” and then have to be reviewed by tax analysts.

- Taxpayers are not properly registered with the Department prior to submitting payments/returns. In these cases, accounts are not established for tax types and payments/returns cannot be credited to taxpayers' accounts.

- Taxpayers fail to complete the entire ST-103 returns and/or Forms WH-1 and the annual WH-3. Each month, the Department receives thousands of incomplete returns. These returns cannot be automatically processed and are “suspended” until they can be manually reviewed, corrected, and posted to taxpayer accounts.

- Taxpayers do not use their complete Indiana Taxpayer Identification (TID) Numbers on forms and in correspondence. Indiana Taxpayer Identification Numbers use the 10-digit TID Numbers with the three-digit location number and do not drop leading zeros. Our processing system requires all 13 digits. If taxpayers have coupons with 10-digit TID Numbers, the three-digit location number, and then a single-digit, they may drop the 14th digit.

- Taxpayers send in photocopied returns being used for other time periods or other taxpayers. The information in the scanlines on preprinted returns determine where that return is credited or posted.

- Taxpayers are not using the Change Form when their businesses and/or locations close. In these cases, the respective business registrations need to be permanently closed by the Department. This form is included in the coupon booklet. Taxpayers need to check the box located under the space for telephone number and enter the close date. This should be used when a specific location has PERMANENTLY CLOSED (no longer in business). This should not be used if the business is being closed only temporarily (such as a seasonal business).

- On business tax applications, taxpayers need to include their township information. The Department has to have this information, because it is required to forward it on to the respective counties.

- When filing amended returns, taxpayers are not clearly marking the top of the form to state “AMENDED” returns.

Corporate Income Tax

- Taxpayers are not entering their correct Indiana-issued Taxpayer Identification Number (TID) in the Indiana Taxpayer Identification Number field of tax forms. They are entering either their Federal Identification Number (FID) or a variation or shortened version of the Indiana TID.

- For tax periods beginning in 2002 and ending in 2003, the Department requires the IT-20 “Fiscal” return and has sent out several mailings with the correct corporate return included. However, taxpayers continue to file the incorrect return.

- When claiming withholding credits on Forms IT-65 or IT-20S, taxpayers are not attaching the WH-18's as verification of the credits claimed. Credits without this verification cannot be allowed.

•Taxpayers are not answering the question, “Is an extension of time to file attached?” on their Indiana corporate returns (e.g., IT-20, IT-20S, IT-65) when state or federal extension forms are attached.

Electronic Funds Transfer (EFT)

Taxpayers who register to remit Sales/Use Tax by Electronic Funds Transfer receive quarterly recap coupons. In error, they begin remitting on a quarterly basis, rather than monthly as required. **Registering for and remitting by EFT does not change the taxpayer’s filing frequency (due dates).** Remitting tax payments quarterly results in late payment penalty and interest assessments for the first two months of the quarter.

Some Sales/Use tax EFT taxpayers remit by EFT each month but fail to file the quarterly recaps, which results in delinquency notices being issued to the taxpayer. The quarterly recaps are required by law.

Some EFT withholding taxpayers are contacting the Department requesting monthly and quarterly coupons. Taxpayers who remit Indiana state and/or county withholding taxes by EFT are not required to file returns throughout the year. The only required return is the annual reconciliation form, WH-3.

Some service providers send ACH credit payments for taxpayers who aren’t registered for EFT and/or the tax type of the payment being submitted.

Missing Earned Income Credit Data on Indiana Electronically-Filed Returns

For the past two years, we have received electronically-filed Indiana IT-40 Tax Returns with taxpayers claiming the Indiana Earned Income Credit but omit some or all of the data from the electronic Indiana IN-EIC Schedule.

Tax software is supposed to carry the data entered on the Federal EIC Schedule through to the Indiana IN-EIC Schedule, eliminating the need for the user to key in the data twice. However, whenever the designated child is someone other than a natural child, grandchild, or foster child (e.g.: niece, nephew, sister, brother), often none or part of the required information doesn’t carry through properly.

We brought this issue to the attention of the affected software companies last year, and most fixed the problem. However, at the beginning of the 2005 filing season, we experienced this same issue with some vendors. After repeated calls again this year, we again resolved the issue, but not before several thousand returns came through with missing data.

Electronic Filing

The Department is still receiving hundreds of Indiana Forms IT-8453 (Declaration of Electronic Filing) from both Electronic Returns Originators (ERO’s) and taxpayers. When taxpayers use the Federal/State E-File Program, Indiana requires ERO’s to keep and maintain Form IT-8453 until December 31 of the third year after the return was signed and transmitted. Taxpayers who use either the Federal/State Internet Filing Program or Indiana’s I-File Program need to keep and maintain their IT-8453 for three years, themselves. **Nothing should be mailed to the Indiana Department of Revenue from electronic filers.**

COMPLIANCE DIVISION

AERONAUTICS/TAX CLEARANCES SECTION

The Aeronautics Section mailed 5,062 aircraft registration renewals for the calendar year 2004 with five owners in delinquent status as of December 2004. This translates into a 99.9 percent renewal compliance rate.

Indiana Code 6-6-6.5-2 states that any Indiana resident who owns an aircraft must register the aircraft within 31 days from the purchase date. Any nonresident who bases an aircraft in this state for more than 60 days shall register the aircraft with the Department no later than 60 days after establishing a base in Indiana.

Corporate Dissolutions

This section has received 1,244 notices of corporate dissolution. Indiana Code 6-8.1-10-9 provides that any corporate officer or director becomes personally liable for all taxes, penalties, interest, and fees associated with

the collection of liabilities for a period of one year from the date the Department is notified of the corporation's dissolution. The corporate officers or directors become personally liable, because the dissolving corporation distributed corporate assets before all liabilities were satisfied. Corporate officers or directors may be absolved of any personal liability by obtaining a Certificate of Clearance from the Department. The Certificate of Clearance certifies that all liabilities due the Department have been satisfied.

Reinstatements

Corporations that are administratively dissolved by the Secretary of State's Office for noncompliance must obtain a Reinstatement Certificate of Clearance from the Department verifying the corporation is in good standing before they can be reinstated with the Secretary of State. The Department issued 2,665 Certificates of Clearance and denied or closed 979 requests due to outstanding issues.

Letters of Good Standing

Corporations in the process of obtaining financial loans or other state agency grant or award approval will request a Letter of Good Standing. The Department has issued 2,175 Letters of Good Standing and denied 1,010 requests due to missing returns or unpaid liabilities.

Responsible Officer Billings

Responsible Officer Billings were generated for trust taxes representing a total due of \$7,021,099 not paid by corporations.

Federal Audits

If taxpayers do not amend their Indiana Corporate Income tax returns to report Indiana adjustments resulting from the federal modifications detailed in agreed-to federal Internal Revenue Service audit findings, a state tax assessment is generated. For Fiscal Year 2005, corporate taxpayers were billed a total of \$2,371,752.

Voluntary Compliance Program

Taxpayers who discover that they may have nexus with Indiana but have not filed returns frequently contact the Department to request entering into a Voluntary Compliance Agreement. These taxpayers are often confused or unaware of filing requirements for income tax and/or sales/use taxes in Indiana. Tax due is not forgiven, nor is interest abated. Voluntary Compliance Agreements resulting in \$10,314,865 of taxes collected were entered into for the fiscal year ending June 30, 2005.

Neighborhood Assistance Program

The total Neighborhood Assistance Credits allowed in Fiscal Year 2005 can not exceed \$2.5 million. The Indiana Department of Commerce verifies donations made to qualified Neighborhood Assistance Organizations. The Indiana Department of Revenue tracks the donations from various business entities, allowing 50 percent of allowable donations as credits against adjusted gross income tax. The Department processed 4,778 tax credits for the FY05.

BANKRUPTCY SECTION

The Indiana Department of Revenue's Bankruptcy Section once again had a busy and productive fiscal year. The section received 11,036 incoming phone calls from taxpayers, attorneys, bankruptcy trustees and other Revenue divisions. Tax Analysts placed 4,500 outgoing phone calls during the 2005 period.

The Bankruptcy Section received 110,559 pieces of incoming correspondence, which includes the regular mail, e-mail, affidavits and faxes. This section generated 15,977 pieces of outgoing mail, including faxes, memorandums to the Attorney General's office, letters and e-mail messages to taxpayers, attorneys and trustees. The Section's 14 tax analysts also received, edited and processed 5,142 tax returns.

The Bankruptcy Section received and processed 9,574 payments from taxpayers and trustees, which resulted in \$24,712,594 in total payments on Bankruptcy accounts.

In all, 4,349 Chapter 7 Asset, Chapter 13 and Chapter 11 claims were filed, with a net assessment totaling \$76,711,273.

Three Bankruptcy clerks reviewed 26,615 Chapter 7 “No Asset” notices and placed “holds” in the Bankruptcy database and RPS case management when liabilities were present. The clerks also reviewed 25,578 discharges and released the “holds” when the cases were closed.

Once again, one of the section’s special projects for the year was to review older cases and determine if cases were active or inactive. This project resulted in a total of 4,802 additional cases being closed for the year.

INDIVIDUAL/WITHHOLDING/CORPORATIONS TAX SECTION

The Individual Income Tax Section’s mission is to identify and pursue non-filers, as well as to verify the accuracy of filed returns by utilizing information from the Internal Revenue Service, various Indiana state agencies, other states’ taxing agencies and anonymous informants. The standard compliance projects and findings for Fiscal Year 2005 are as follows.

Federal Audits

Information is obtained from the Internal Revenue Service concerning agreed-to federal tax audit reports to the Department. If taxpayers do not amend their Indiana Individual Income tax returns to report the Indiana adjustments resulting from the federal modifications detailed in the audit findings, a tax assessment is generated. For this fiscal year, this section billed 785 Individual taxpayers for \$4,256,192.

CP2000 Unreported Income

The Department obtains data from the Internal Revenue Service regarding taxpayers who failed to report all taxable income. This could be income derived from wages, interest, dividends or non-employee compensation. These types of income should be reported on W-2’s or Form 1099 information returns. An assessment is generated if income was not reported on the original returns. The project resulted in 30,103 taxpayer assessments for \$12,098,856.

Federal/State Cross Check

The Department obtains magnetic tape information from the Internal Revenue Service disclosing adjusted gross income and exemptions reported on federal returns. This information is compared to the state-reported adjusted gross income and exemptions from our master file. Automatic billings are then generated for any state and county tax due on the differences. This project resulted in 23,911 taxpayer assessments for \$10,237,476.

Individual Desk Audits

Individual desk examinations are performed based on anonymous sources or submissions from other divisions within the Department. The examination may consist of verifying income reported, credits/deductions taken, or the amount of refund requested. Individual desk audit resulted in 70 assessments of \$116,692.

Riverboat Project

The Indiana Department of Revenue obtained information on Indiana riverboat winnings received during 2001 and 2002 from federal Form W-2G (Certain Gambling Winnings). This information was sorted and approximately 12,000 letters were mailed to those nonresident winners who did not report this taxable income to the state of Indiana, resulting in \$774,546 additional tax revenues being collected in Fiscal Year 2005. (Beginning July 1, 2002, Indiana State Tax is automatically withheld from riverboat winnings in excess of \$1,200).

NONPROFIT/CHARITY GAMING/FIDUCIARY TAX SECTION

This section is responsible for determining nonprofit organizations’ eligibility for sales tax exemption and for licensing qualified nonprofit organizations for bingo, festivals, raffles, door prizes and charity gaming nights. This section also licenses manufacturers and distributors to sell tip boards, punchboards, pull-tabs and bingo equipment and supplies.

A total of \$3,791,165 in gaming fees were collected from the following licenses issued:

•Annual Bingo	857
•Charity Game Night	314
•Door Prize	7

•Festival	321
•Raffle	780
•Special Bingo	<u>173</u>
Total Licenses Issued	2,452

The following gaming license fees were collected:

Gaming License Fees	\$ 3,791,165
Manufacturers Licenses	\$ 48,000
Distributors Licenses	<u>\$ 110,000</u>
Total Fees Collected	\$ 3,949,165

During Fiscal Year 2006, the Charity Gaming Section will conduct seven educational/training seminars, which will be held in Clarksville, Fort Wayne, Indianapolis, Jasper, Lafayette, Michigan City and Richmond. Some of the topics covered will be:

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| •Legislative changes for Charity Gaming | •Revised Publication 2 |
| •Charity Game Nights | •60/60 law |
| •Bookkeeping – how it affects your organization | •Illegal machines |
| •Revised forms, including CG-8 and CG-21 | •Duck Races |

Fiduciary Tax Section

This section processed 55,927 fiduciary returns for Fiscal Year 2005, representing a total of \$27,587,443 in taxes collected.

CONSUMER USE TAX, UTILITY/TRUST/FUEL/SALES REFUNDS SECTION

Utility exemption requests for sales tax were received from 9,804 applications for Fiscal Year 2005. More than 9,300 of the applicants qualified for a full (100 percent) exemption on their purchases of public utility services. These applicants were primarily government, nonprofit organizations and companies whose use of the energy was predominately for an exempt purpose.

Approximately 260 business entities, such as restaurants and industrial processors, received less than a 100 percent utility exemption. Companies qualifying for a partial exemption must pay sales tax on their utility bills to their suppliers and then file annual refund claims for exempt percentage allowed. Another 200 applications were denied an exemption on the requested utility service as a result of desk examinations.

Consumer Use Tax

Collections totaling approximately \$3.1 million in consumer use taxes were processed. The majority of the dollars were collected either from out-of-state companies that owed Indiana use tax or from companies not registered in Indiana that collected sales tax from their Indiana customers. Monies collected as a result of consumer use tax bills totaled \$583,859.

Fuel Tax Refunds

This section examined 4,139 Fuel Tax refund claims during the year. These claims were filed by government entities, companies and individuals who paid Gasoline Tax and Special Fuel Tax on fuel subsequently used in an exempt manner.

Trust Tax Refunds

A total of 3,969 Trust Tax claims were reviewed for Fiscal Year 2005. Of these, approximately 83 percent were completed within the section, 434 claims were forwarded to the Audit Division for review. Another 254 were forwarded to other areas (Withholding, Corporations, or Individual) for determination.